

Message Text

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INFO OCT-01 NEA-10 ISO-00 EB-07 TRSE-00 OMB-01 L-03
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TO AMEMBASSY KATHMANDU
INFO AMEMBASSY KUWAIT

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E.O. 11652: N/A

TAGS: ECRE, BENC, NP

SUBJECT: MAJOR PROJECT: KULEKHANI HYDROELECTRIC

REF: (A) KATHMANDU 13; (B) 76 KATHMANDU 4743

1. COMMERCE CONTACTED W.H. MCMURREN OF MORRISON KNUDSON (M-K) ON JANUARY 5 RE ITS DECISION NOT TO BID ON SUBJECT PROJECT. ALTHOUGH ANTI-BOYCOTT PROVISIONS IN TAX REFORM ACT WERE NOT THE ONLY PROBLEMS FACED BY M-K IN CONSIDERING BID, THEY PROVIDED THE CLINCHER.

2. MCMURREN EXPLAINED THAT CIVIL WORKS FOR PROJECT (WHICH
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WAS AREA OF M-K INTEREST) DIVIDED INTO TWO PARTS: (1) PRELIMINARY (UNDERGROUND) WORKS TO BE FINANCED BY KUWAIT FUND LOAN; AND (2) REGULAR CIVIL WORKS TO BE FINANCED BY IDA LOAN. THIS CONFIRMED BY EXAMINATION OF IDA LOAN APPRAISAL DOCUMENT. M-K WAS INTERESTED ONLY IF IT COULD BID THE COMPLETE PACKAGE, SINCE COMPANY FELT THIS WAS ONLY WAY TO INSURE PROPER SCHEDULING. ALTHOUGH M-K CAPABLE OF

UNDERTAKING BOTH COMPONENTS ALONE, IF FELT THAT LOGISTICAL HELP TO GET MATERIALS AND EQUIPMENT THROUGH INDIA AND TO SITE WAS ESSENTIAL FOR SUCCESSFUL OPERATION. ACCORDINGLY, M-K WAS CONSIDERING HOOKING UP WITH INDIAN FIRM WHICH

HAD CAPABILITY TO UNDERTAKE PRELIMINARY CIVIL WORKS. PLAN WAS TO HAVE M-K/INDIAN TEAM BID COMPLETE PACKAGE, WITH INDIAN FIRM DOING PRELIMINARY PORTION AND PROVIDING THE REQUIRED LOGISTICAL SUPPORT.

3. PROPOSED DEAL WITH INDIAN FIRM HAD ENCOUNTERED LEGAL PROBLEMS AND WAS FLOUNDERING WHEN TAX ACT SIGNED INTO LAW ON OCTOBER 4. MCMURREN WAS IN NEPAL AT THE TIME, AND ADVICE HE RECEIVED FROM U.S. WAS THAT COMPLIANCE WITH KUWAIT BOYCOTT REQUIREMENT WOULD PROBABLY PUT COMPANY AFOUL OF TAX ACT PROVISIONS. MCMURREN REPORTS THAT AT THAT TIME HE INVESTIGATED LOCALLY THE POSSIBILITIES OF HAVING PRELIMINARY AND REGULAR CIVIL WORKS LET AS SEPARATE CONTRACTS, BUT WAS NOT ENCOURAGED WITH PROSPECTS. M-K WOULD LIKELY BE UNABLE INFLUENCE SELECTION OF PRELIMINARY CIVIL WORKS CONTRACTOR, AND COMPANY WOULD BE PREPARED TO BID ONLY IF IT COULD EXERCISE SOME CONTROL OVER SUCH CONTRACTOR FOR SCHEDULING COORDINATION. POSSIBLE

SOLUTION WOULD HAVE BEEN FOR INDIAN FIRM TO GET PRELIMINARY WORKS CONTRACT AND REACH WORKING AGREEMENT WITH M-K, BUT THERE WAS NO ASSURANCE THIS WOULD HAPPEN.

4. AFTER CLOSE SCRUTINY OF TREASURY DEPARTMENT GUIDELIMITED OFFICIAL USE

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LINE TO ANTI-BOYCOTT PROVISIONS OF TAX ACT ISSUED ON NOVEMBER 4, M-K ATTORNEYS CONCLUDED THAT EXECUTION OF BOYCOTT CERTIFICATE REQUIRED BY KUWAIT FUND AS CONDITION OF CONTRACT WOULD BE CONSTRUED AS PARTICIPATION IN A BOYCOTT BY THE ACT'S DEFINITION AND THUS RESULT IN M-K LOSS OF U.S. TAX CREDIT FOR TAXES PAID GON. THIS ALONE WOULD ELIMINATE INCENTIVE TO BID. CERTIFICATE STATED GOODS COULD NOT BE PROCURED FROM ANY COUNTRY OR COMPANY PROHIBITED BY KUWAIT BOYCOTT REGULATIONS. THIS WOULD REQUIRE M-K TO REFUSE TO PROCURE FROM ANY U.S. FIRM ON BOYCOTT LIST. TAX ACT EXPLICITLY DEFINES AS PARTICIPATION IN A BOYCOTT (INVOKING DENIAL OF TAX BENEFIT) AGREEMENT BY U.S. FIRM TO REFRAIN FROM DOING BUSINESS WITH ANOTHER FIRM BECAUSE OF LATTER'S BUSINESS RELATIONS WITH BOYCOTTED COUNTRY (ISRAEL IN THIS CASE); BELIEVE THIS DEFINITION WAS INTENDED TO APPLY IRRESPECTIVE OF ANY WORLD BANK COMPONENT IN PROJECT FINANCING.

5. SIMILAR INSTANCE OCCURRED EARLIER IN CONNECTION WITH

PROJECT IN INDONESIA FINANCED JOINTLY BY WORLD BANK AND SAUDI DEVELOPMENT FUND. PROBLEM OF BOYCOTT CERTIFICATE REQUIRED BY SAUDIS RESOLVED IN CASE OF PROSPECTIVE U.S.

CONTRACTOR BY GOI/WORLD BANK AGREEMENT WHEREBY ONLY WORLD BANK MONEY WOULD BE USED TO PAY U.S. CONTRACTOR, THUS AVOIDING NECESSITY FOR EXECUTION OF BOYCOTT CERTIFICATE. STRUCTURE OF FINANCING FOR KULEKHANI PROJECT MAY NOT PERMIT SIMILAR SOLUTION. NEVERTHELESS, COMMERCE SUGGESTED TO MCMURREN THAT M-K EXPLORE SUCH POSSIBILITY WITH WORLD BANK IN WASHINGTON. SUCH A SOLUTION FOR AVOIDING NECESSITY OF BOYCOTT CERTIFICATE APPEARS ESSENTIAL TO M-K RECONSIDERATION OF ITS POSITION. MCMURREN INDICATED M-K STILL INTERESTED IN PROJECT AND MIGHT CONSIDER BIDDING IF THIS AND OTHER PROBLEMS CAN BE WORKED OUT. M-K PLANS TO HAVE DISCUSSIONS WITH WORLD BANK AND HAS PROMISED TO REPORT RESULTS TO COMMERCE. LIMITED OFFICIAL USE

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6. FOR EMBASSY'S INFO, MCMURREN NOTED OTHER PROBLEMS THAT MAY HAVE CONTRIBUTED TO MAGNITUDE OF KOREAN AND JAPANESE BIDS. ONE IS THAT THE ROAD GON IS COMMITTED TO BUILD TO SITE IS BEHIND SCHEDULE, RAISING DOUBTS IN M-K'S MIND ABOUT ABILITY TO GET MATERIALS TO CONSTRUCTION SITE. SECONDLY, MCMURREN NOTED THAT INITIALLY THE CONTRACTS WERE TO BE TAX FREE IN NEPAL, BUT SUBSEQUENTLY GON DECIDED TO APPLY NEPAL INCOME TAX TO CONTRACTOR. ACCORDING MCMURREN, GON RATIONALE WAS THAT M-K COULD TAKE CREDIT AGAINST U.S. TAX FOR TAXES PAID NEPAL, AND THUS END UP PAYING IN TOTAL ONLY THE AMOUNT OF THE U.S. TAX, SO WHY SHOULD NEPAL NOT GET THE BENEFIT OF THE TAXES. MCMURREN TOLD THEM THIS WOULD BE TRUE IF M-K HAD NO OTHER ACTIVITIES ABROAD. HOWEVER, COMPANY WORKS WORLDWIDE AND FACES A PROBLEM OF AVERAGING FOR TAX CREDIT PURPOSES. GON ACTION CONSIDERABLY REDUCED ATTRACTIVENESS OF PROJECT TO M-K. ALSO, M-K WOULD STILL FACE PROBLEM OF ARRANGING FOR LOGISTICAL SUPPORT IN INDIA WHICH IT FEELS IS NECESSARY.

7. IN CONCLUSION, EVEN A SOLUTION OF BOYCOTT PROBLEM DOES NOT INSURE THAT M-K WILL BID ON PROJECT. COMPANY INDICATED ONLY THAT IT WILL RE-EXAMINE ITS POSITION. GON SHOULD ALSO BE AWARE THAT THERE NEVER WAS ANY ASSURANCE, AND IS NONE NOW, THAT ANY M-K BID WOULD BE CLOSER TO PROGRAMMED ESTIMATE THAN KOREAN OR JAPANESE BIDS. WILL REPORT FURTHER DEVELOPMENTS. KISSINGER

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